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U.S. DEPARTMENT OF TRANSPORTATION, BEFORE
THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES, AND
BUSINESS RIGHTS, SENATE COMMITTEE ON THE JUDICIARY
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Good morning, Mr. Chairman and Members of the Subcommittee. It is a pleasure to be here today to discuss the state of competition in the airline industry and the effect of recent airline mergers and acquisitions on competitive behavior.

I would like to begin my testimony by discussing the major forces that are shaping the structure and behavior of the airline sector as this relates to industry competition. Next, I will discuss in considerable detail the administrative procedures as well as the analytical and legal criteria we consider at the Department of Transportation in reaching our decisions on mergers and acquisitions. Finally, I will review each of the Department's decisions to give this Subcommittee a thorough explanation of why and how we arrived at our conclusions.

As you know, the aviation industry was deregulated in 1978 and the reforms brought by this change in economic policy shape today's market. Airline deregulation has been one of the most important and successful federal policy initiatives of the past generation. The traveling public has benefited enormously from the range of price and service options spurred by deregulation. A Brookings Institute study estimates that this policy has provided the consumer with $6 billion annually in benefits. Air carriers,

too, have benefited, largely from the enhanced ability to adjust price and service offerings in response to changing economic conditions and consumer preference. Without this flexibility, air carriers would have been much more susceptible to the generally adverse economic conditions experienced during the early part of this decade. Furthermore, an article in Dun's Business Monthly notes that the economy has prospered due to the reforms of deregulation. "In aviation alone," the article says, "deregulation has increased the nation's gross national product by $8 billion in 1977 dollars ... that equals a permanent 0.4 percent increase in GNP."

Let's consider a few other key developments in the industry since enactment of the Airline Deregulation Act in 1978:

* In October 1978, 34 certificated airlines provided scheduled passenger service, three provided scheduled all cargo service and eight provided charter services. Today, 137 certificated airlines are operating. Of these, 50 offer scheduled jet passenger services.
* Between October 1978 and October 1986, scheduled revenue passenger-miles increased 63 percent (from 222 billion to 361 billion). Passenger enplanements increased 53 percent (from 269 million to 413 million).
* Scheduled available seat-miles have increased 66 percent since 1978.

* In October 1978, the industry work force totaled 341,315 full-time and part-time employees. By October 1986, employment had increased to 444,866.
* Also, the number of competitive markets jumped from 1,126 to 1,834 between February 1978 and February 1987.

Most importantly, Mr. Chairman, competition has been enlivened by deregulation. In fact, competition in the industry today is more dynamic and diverse in its many elements than it ever has been. Airline deregulation has worked, is working, and, given the Department's commitment to preserving a competitive environment, will continue to work.

We must recognize that changing industry operating practices and marketing strategies are working to reshape the structure and business practices of the airline industry to the benefit of competition. Although not every air carrier has benefited equally in this revamping of the industry, these developments, overall, serve to promote competition, and <u>that</u> is the intent of deregulation.

One of the most significant developments in airline operations has been the establishment and growth of hub-and-spoke route networks. In the post-deregulation era, air carriers have adopted exciting, innovative competitive strategies, like the hub-and-spoke

mechanism, that emphasize traffic retention -- that is, retaining travelers through their entire trip.

The benefits of hub-and-spoke networks to air travelers and carriers are substantial. Most passengers prefer nonstop service; however, the number of city-pair markets that can support nonstop service is quite small. In lieu of a nonstop flight, there is a preference to remain on the same airline by taking either a single plane or a connecting flight. Hub-and-spoke operations increase these possibilities. In addition, passengers traveling to and from low-density markets have much greater access to a large number of markets through the hub airport than they did previously.

For airlines there are two major benefits to the hub-and-spoke systems. The first is the increased revenue that results from retaining more passengers on-line. The second is the more efficient use of aircraft and personnel. By consolidating operations at a hub airport, a carrier can increase its load factors on most flights into and out of a hub airport.

The growth in hub-and-spoke route networks allows competitors to take different forms -- there may be direct competition among those carriers serving a hub or among different carriers that provide competing services over alternative hubs. The fact that passengers can generally reach their destination by connecting with different carriers through alternative hubs expands the range

of consumer choice and enables competition to flourish. In fact, the growth of hub-and-spoke route systems has increased competition among hubs. For example, passengers traveling between the east and west coasts can choose among carriers offering competitive service through Minneapolis/St. Paul, Chicago, Pittsburgh, St. Louis, and other locations. The relative ease with which air carriers can enter a market serves to exert considerable pressure on incumbents to provide competitive fares and services, even in concentrated hub markets. And, in studying competitive possibilities, the Department believes that the appropriate approach is to focus on freedom of entry and barriers to entry in considering the availability of expansion and/or new entrants.

New hubs have also been developed. American Airlines has expanded service at Nashville and is in the process of building a major hub at Raleigh/Durham; Piedmont has developed Charlotte and Baltimore into major hubs; and United's growing presence at Dulles will provide increased competition for north-south and east-west traffic.

The policy of deregulation has also had a profound effect on the internal efficiencies of the industry. During the initial phases of deregulation, the large, established jet operators had higher costs than new entrants. However, in a competitive environment, the established carriers were compelled to become more efficient and cost competitive with these new entrants in order to survive.

As the major carriers have become more efficient, they have been able to expand their operations and, predictably, increase nationwide competition.

The experience of American Airlines is an excellent example of how an established carrier has transformed itself into a major competitive force. American pursued a strategy of rapid internal growth -- a strategy that, to be successful, is contingent upon American continuing to lower its costs. Such reductions have been achieved largely through the hiring of new employees at market wage rates and through more efficient operating practices. Expansion has been particularly strong at American's major hubs (Dallas/Ft. Worth and Chicago), and the carrier has recently expanded service at its new Nashville hub (opened April 1986). American will offer additional domestic service when its Raleigh/ Durham hub is completed (mid-1987). The airline is also providing new service to Europe and expanded service in the Caribbean.

Evidence of increased competition in today's market is also available in the development of imaginative marketing programs utilized by the carriers. Frequent flyer programs, for instance, are an integral part of today's marketing practices. And, it is generally acknowledged that a large service network improves the marketing strategy of these programs making it easier for passengers to accumulate the necessary mileage to participate in the plans and also offers consumers a greater variety of attractive destinations. Air travelers value these programs

highly. And carriers must continue to adjust their marketing practices and service networks to accommodate consumer preferences.

Finally, our international carriers have found that, in order to compete effectively with foreign carriers, they must exploit their natural advantages in their home market. This includes feed from on-line domestic connections. This allows our carriers to offer direct services from a large number of interior U.S. points to foreign destinations - to the benefit of both U.S. carriers and consumers alike. In fact, Congress specifically recognized in 1980 these factors in establishing the international aviation policy of the United States, contained in section 1102(b) of the Federal Aviation Act.

It should come as no surprise then that U.S. air carriers have responded to these developments by seeking to consolidate and ensure the efficiencies necessary to maintain their long term viability in a competitive marketplace. The consumer's preferences for on-line services, frequent flyer programs and better access to foreign markets has created an environment where large carriers have significant competitive advantages in the national marketplace. The whole point of deregulation was to create a marketplace where consumers, not the government, would determine the structure of the industry -- and that is precisely what is happening today. Airlines are now competing more vigorously than ever to deliver what the consumer wants.

Mr. Chairman, the airline industry is transforming itself. The forces that are propelling these changes affect service networks, operations, marketing practices, and competitive behavior. Overall, these forces are working to strengthen competition in the airline industry, not weaken it.

I would now like to focus attention on consolidations and our legal approach to considering mergers and acquisitions.

As you know, the Department of Transportation has considered a number of mergers and acquisitions during this past year. This consolidation has been the focus of much attention and not a little concern. Let me say, Mr. Chairman, during our consideration process we have acted with great care and, certainly, within the guidelines set by Congress upon passage of the Airline Deregulation Act. Section 408 of the Federal Aviation Act of 1958 governs airline mergers and acquisitions. That section requires the Department's prior approval for the acquisition of control of one air carrier by another carrier or person controlling another carrier.

Today, section 408 embodies antitrust standards traditionally applied by the courts to unregulated industries. But, it was not always that way. In fact, prior to 1978, this section conferred broad discretion on the Civil Aeronautics Board to approve or disapprove airline mergers and acquisitions under a "public

interest" test. History shows that there were times when the CAB used this authority to disapprove mergers, not because they harmed competition per se, but rather because they could tear the fabric of the highly structured route network that the Board had created over time. In fact, I know of at least one case in which the CAB rejected a merger precisely because it would have promoted competition thereby diverting traffic and revenues from other members of the "club".

That the CAB should have applied section 408 in this fashion is not surprising, since that section was an integral part of a then intensely regulated regime which valued protection and governmental intervention over competition and market-oriented decision-making.

When it became clearly evident by the mid-to-late seventies that the aviation industry could operate more effectively and efficiently without the constraints of federal economic regulations, Congress responded by adopting the Airline Deregulation Act of 1978. This measure amended the Federal Aviation Act and brought the law governing airlines closer to laws governing non-regulated industries. The foundation of the new statute was, and continues to be, that it is in the public interest to allow the airline industry to be governed by the forces of the marketplace.

It is in this setting that the ADA substantially revised section 408 of the Act. Consistent with the deregulated environment in which air carriers would be operating, the major purpose of the amendments was to ensure that airline mergers and acquisitions would be tested by the antitrust standards applicable to unregulated industries. In enacting these changes, Congress indicated that section 408 must be administered consistent with its intent to move the industry rapidly towards deregulation. The Conference Report to the Deregulation Act, in explaining the changes to section 408, stated clearly that, "The foundation of the new airline legislation is that it is in the public interest to allow the airline industry to be governed by the forces of the marketplace."

Accordingly, section 408 now requires the Department to approve an acquisition (1) that will not result in a monopoly or further an attempted monopoly and that will not likely lessen competition substantially in any region of the United States, and (2) that is not inconsistent with the public interest. Section 408 requires the Department to disapprove transactions that do not satisfy these standards, unless the Department finds that they meet significant transportation needs and conveniences of the public that cannot be met through any reasonably available alternative transaction that would be materially less anti-competitive. Section 408 also empowers the Department to impose such conditions on its approval as are considered just and reasonable.

Furthermore, whereas prior to passage of the reforms, when all mergers approved under section 408 of the Act were granted automatic antitrust immunity under section 414 of the Act, the ADA made the grant of antitrust immunity in a merger proceeding discretionary. It should be noted, however, that section 414 was amended again to provide that if an anticompetitive agreement is approved because it offers public benefits or serves transportation needs, and no less anticompetitive means are available, the agreement must be granted antitrust immunity.

In exercising its antitrust authority, the Department has been mindful of the procompetitive policy orientation of the new section 408 of the Act. We wholeheartedly support Congress' approach and have followed its direction. For this reason, the Department usually has not become involved in the details of the proposed transaction beyond that involvement necessary for a sound competitive review. It has specifically refrained from passing judgment on whether the transaction under consideration would be profitable, and, if consistent with the antitrust laws, whether it will divert traffic from other carriers. We strongly believe that the marketplace should be the principle discipline for the carriers' business decisions. It is also our conviction that DOT's principal role in a deregulated environment is to protect the competitive process, not individual competitors.

Accordingly, the Department has examined the competitive effects of airline mergers and acquisitions under the standards

established by section 7 of the Clayton Act, which governs mergers and acquisitions in unregulated industries. Our approval of mergers and acquisitions has been based on well-developed evidentiary records that show that there is no likelihood of a substantial reduction in competition in any relevant markets.

Therefore, Mr. Chairman, the primary focus of the Department's inquiry in each merger case is, as Congress intended, on the competitive consequences of the transaction. Our approach recognizes the important role that competition plays in disciplining carriers' pricing and service decisions, and, therefore, focuses on those considerations that affect competitive performance. For this reason, the Department's merger analysis carefully examines the structural characteristics of the markets at issue -- characteristics that are most likely to determine the ability of competitors to check the exercise of market power by the merged carrier. In this context, the crucial question in each case is whether the merged carrier would be able to raise prices above or reduce service below, competitive levels.

Deregulation gave airlines the right to enter and exit markets without governmental supervision. The effective exercise of this right is essential to ensuring a competitive airline industry. It provides carriers with the opportunity to choose the markets they will serve and to respond to any perceived deficiencies in market performance. There is little doubt that freedom of entry exerts considerable pressure on incumbent carriers to provide competitive

fares and services, and that entry barriers have precisely the opposite effect.

It is against this background that the Department, in reviewing airline mergers and acquisitions, carefully examines the degree to which other carriers can freely and effectively enter the markets that will be served by the merged carriers. In this regard, we review the applicants' national market share and consider whether there are significant barriers to entry at the airports which they serve. Where the freedom to enter a market is not unduly constrained, and can be relied upon to maintain the consumer benefits afforded by meaningful competition, the Department believes that mergers are fully consistent with the applicable statutory requirements and should be approved. In examining the competitive consequences of a proposed merger, we have found valid the Civil Aeronautics Board's principle that the change in the amount of concentration in individual city-pair markets is usually not a useful guide to the acquisition's competitive effects. We have found, as did the Board, that concentration statistics are not ordinarily useful since airline markets are competitive, even though highly concentrated under standard measures, because the ease of entry will permit other carriers to quickly begin serving a route if the incumbent carriers charge supracompetitive fares or operate a level of service below the competitive level. Instead of relying on concentration figures, we engage in a functional analysis that examines how an acquisition is likely to affect the

markets at issue in light of the airline industry's economics and operating practices.

In those instances where competition may be reduced and therefore cannot be relied upon to protect consumers, the Department will disapprove the merger. The Department does not, however, specify the conditions that would allow us to approve the transaction. Rather, we identify the competitive problems that preclude our approval of the transaction, and leave it to the parties to devise a remedy for those problems. The parties then have to submit a revised proposal to the Department for review if they choose to proceed with the merger or acquisition.

I would like to emphasize that the Department has not approved any section 408 transaction on the ground that the transaction, although anticompetitive, meets transportation needs and public benefits that cannot be obtained by any reasonably available, less anticompetitive transaction. Nor has the Department granted antitrust immunity under section 414 of the Act to any transaction approved under section 408.

I would also like to emphasize that while the public interest standards of section 408 were retained, Congress in enacting the Airline Deregulation Act directed that those standards be interpreted in light of the intent of Congress to move the airline industry rapidly towards deregulation. Consequently, both the Department and the CAB have construed the non-competitive public

interest aspects of merger and control transactions narrowly. Generally speaking, this has been limited to careful scrutiny of labor-related issues that have been presented in the context of merger cases. As directed by the Act, the Department has considered the likely impact of each transaction is on fair wages and equitable working conditions. We have reviewed the record in each case to determine whether employees' interests can be adequately protected through the collective bargaining process, and if not, whether the Department should intervene in labor-management issues by, among other things, imposing labor protective provisions.

We try to render our decisions fairly and expeditiously. Before the ADA, merger and acquisition proceedings were usually the object of a very tedious, expensive and time-consuming process. Virtually all applications involving these transactions were set for oral evidentiary hearings before a CAB administrative law judge. This resulted in lengthy trials, voluminous exhibits and substantial delays in nearly every case. The typical contested merger proceeding could take as long as two or three years to complete.

Congress appreciated that this situation was incompatible with the deregulated environment because it denied carriers the flexibility needed to respond effectively to changes in the marketplace. Accordingly, in adopting the ADA, Congress determined that the antitrust relationships that required approval under section 408

had to be considered expeditiously. In fact, it specifically amended the Act to require that all applications submitted under section 408 be decided within six months of their submission. Further, it placed upon the opponents of the transaction the burden of proving the anti-competitive effects of the transaction within that time frame.

The Department has acted in accordance with these determinations. We have attempted to decide merger cases promptly and to eliminate bureaucratic red tape that could deny parties the relief they are entitled to receive. We have tailored our procedures to the requirements of specific cases. In doing so, the need to avoid procedural delay has been carefully balanced with the equally important need to provide a full and fair hearing on each application requiring approval under section 408.

We have been successful in meeting these important procedural objectives. The Department has held comprehensive hearings to consider the merits of a number of major merger cases and it has met the six-month deadline established by Congress. Furthermore, the Department has used show-cause procedures to expedite the processing of merger applications where there have been no factual issues whose resolution required an oral evidentiary hearing. In addition, the Department has exempted transactions from section 408 review procedures when they appear to present no significant competitive issues. I will detail these situations in a moment. Similarly, the Department has approved voting trust arrangements

that allow an acquiring carrier to pursue a bid for another carrier without being needlessly delayed by section 408's prior approval requirements, so long as the voting trusts adequately prevent the acquiring party from exercising control of the target carrier during the Department's review of the acquisition.

Mr. Chairman, I would like next to discuss the various particulars of the mergers and acquisitions we have handled to date, but first let me recap briefly the mechanics of our procedures for handling these cases. As noted, section 408 of the Federal Aviation Act provides the statutory framework for the Department's review of the transactions, and the Airline Deregulation Act of 1978 substantially overhauled the substantive provisions of that section. These changes were intended to ensure that, consistent with Congress' intent to deregulate the airline industry, airline mergers and acquisitions would be tested by the antitrust standards traditionally applied by the courts to unregulated industries. The amendments were also designed to promote the expeditious consideration of section 408 cases, and limit governmental interference with decisions reached by airline managers to actions necessary to ensure compliance with the requirements of the new section 408.

Against this background, the Department has, in reviewing airline mergers and acquisitions under section 408, focused on the competitive issues considered under the antitrust laws which apply to unregulated industries. We have refused to substitute our

judgment for that of the marketplace with respect to the economic wisdom of a proposed transaction. Where we have identified competitive problems, we have required the proponents of the transaction to propose modifications to address those problems, as opposed to modifying transactions by government fiat. In addition, we have refrained from becoming involved in the details of a proposed transaction by construing the non-competitive public interest aspects of these transactions narrowly. Finally, the Department has endeavored to decide cases arising under section 408 swiftly, taking into consideration the need to provide a full, fair and thorough hearing on the merits of each case. The Department believes that this approach to mergers and acquisitions reflects the goals and objectives of the new section 408, and, equally important, the over-arching pro-competitive policy orientation of the ADA.

Mr. Chairman, seventeen applications for approval of substantial transactions under section 408 have been filed with the Department of Transportation since the beginning of 1985. The Department has issued final decisions on twelve of those applications, two were withdrawn (Texas Air's 1985 proposed acquisitions of TWA and Frontier), and three are pending decision (the American-AirCal case, the TWA-USAIR case and USAIR-Piedmont). In addition, the Department has acted on a number of applications to exempt an airline acquisition or control transaction from the requirements of section 408, but most of those cases involved acquisitions of relatively small size (e.g., USAir's acquisition of Pennsylvania

Commuter)where no party, including the Department of Justice, raised an objection on competitive grounds.

One acquisition case we considered did not involve a carrier's proposal to acquire a second carrier or a substantial portion of the second carrier's routes. Instead, the transaction involved Northwest's purchase of a 50 percent interest in TWA's PARS computer reservations system (a system marketed to travel agents), Order 86-12-13 (December 4, 1986). The Department exempted the asset purchase from section 408 since we found that it would not substantially reduce competition. Northwest did not own a computer reservations system and it was unlikely that Northwest would enter the CRS industry on its own. Since NWA and TWA stated their intent to ask other carriers to become partners in the marketing of the system, we noted that the transaction might increase competition in the airline industry. We did not, however, rule on whether the proposed operation of the joint venture would be consistent with the antitrust laws.

The majority of the acquisition cases considered by the Department have involved few, if any, significant competitive issues. In three cases, a major airline acquired a commuter carrier (a carrier operating only small aircraft) or a regional carrier to obtain feed traffic to support the major's large aircraft operations. These transactions have been noncontroversial and do not raise serious competitive issues because the acquiring company typically does not serve the type of markets served by the smaller

carrier. Among the transactions of this kind were Piedmont Aviation's acquisition of Empire Airlines, a smaller operator in the Northeast, Order 86-1-45 (January 23, 1986), Alaska Air Group's acquisition of Horizon Air, a commuter operating in the Pacific Northwest, Order 86-12-61 (December 23, 1986), and People Express' purchase of Britt, a midwestern commuter, Order 86-2-34 (February 19, 1986). There was no opposition to any of these transactions on competitive grounds.

Another case, Horizon-Cascade, involved one commuter carrier's purchase of another. Both commuters operated in the Pacific Northwest, Order 86-1-67 (January 30, 1986) (the acquisition was never completed since Horizon decided to withdraw from the transaction; Cascade's financial difficulties caused it to cease all operations within a few months of the application). We reasoned that the acquisition would not have caused a substantial reduction in competition, although the combination of these two commuter airlines would have eliminated direct competition in several Pacific Northwest markets. The acquisition nonetheless was unlikely to reduce competition substantially, largely because other commuter carriers could enter the markets served by Horizon and Cascade, as could major airlines, either on their own or by financing the development of a new commuter airline. Although the acquisition would have eliminated some direct competition, the markets losing competitive service tended to be too small to support competition in the long run.

Alaska Air Group's acquisition of Jet America was another case where the carrier being acquired was of relatively small size -- Jet America served only ten airports with six aircraft, Order 86-9-18 (September 10, 1986). We found that Alaska's acquisition of Jet America -- a transaction unopposed on competitive grounds -- would not substantially reduce competition in view of Jet America's size and the ability of numerous other carriers to compete in its markets. As was true of the target carrier in several other cases, Jet America was also in weak financial condition.

Three other cases involved acquisitions that were essentially end-to-end transactions, that is, the acquiring carrier wished to extend its operations into areas of the country where its operations were relatively insignificant. Such transactions do not eliminate any direct competition -- instead, the acquisition strengthens the acquiring company by expanding its operations thus enabling it to compete more effectively with carriers already providing nationwide service. End-to-end acquisitions include Delta's acquisition of Western, Order 86-12-30 (December 11, 1986), People Express' acquisition of Frontier, Order 85-11-58 (November 20, 1985) and USAir's acquisition of PSA, Order 87-3-11 (March 4, 1987).

In four other cases, Mr. Chairman, the carrier being acquired was in such poor financial condition that its ability to maintain competitive service was, at best, in doubt (in addition to the

cases discussed below, the Horizon-Cascade, People Express-Frontier, and Alaska-Jet America cases involved the acquisition of a carrier in weak financial condition). Midway's acquisition of Air Florida, for example, involved a company which had ceased operations upon filing for bankruptcy and whose restored operations were dependant upon the financial assistance of the acquiring carrier, Order 85-6-33 (June 11, 1985). We also exempted United's acquisition of aircraft, airport facilities and airport slots from People Express, Frontier and Britt because we found that the sale of these assets was necessary to preserve Frontier's service and stabilize People Express' financial condition, Order 86-8-3 (August 1, 1986). In addition, the transaction would not reduce competition, since the sellers would retain sufficient other assets to continue operating as independent competitors.

Southwest Airlines' acquisition of Muse Air also involved a carrier on the brink of collapse. We found that the acquisition was not inconsistent with the standards of Section 408 on two grounds. First, even if the acquisition would otherwise reduce competition (and we found that it would not), it warranted approval under the "failing company" doctrine because Muse was on the verge of competitive collapse and could only avoid financial failure through its acquisition by Southwest, Order 85-6-79 (June 24, 1985). Second, although Southwest and Muse were the only carriers serving Dallas' Love Field, service provided at the Dallas-Fort Worth Regional Airport would provide competitive

discipline for Love Field service and other carriers either were operating a substantial level of service in the applicants' markets or could easily enter those markets. Although the Department of Justice contended that further investigation would be required to substantiate our competitive findings, it agreed that the transaction should be approved under the "failing company" doctrine.

Another acquisition of a carrier in financial trouble -- Texas Air's acquisition of People Express and the assets of People Express' bankrupt subsidiary, Frontier Airlines -- raised more serious competitive issues, although the Department of Justice agreed with us that it was not likely to cause a substantial reduction of competition in any market, Order 86-10-53 (October 24, 1986). Texas Air's subsidiaries competed with People Express in 18 New York City city-pair markets and provided most of the service in the Washington-New York and New York-Boston markets. In addition, Texas Air's subsidiary, Continental Airlines, and Frontier each used Denver as a hub. We determined that the acquisition would not be anti-competitive in the New York City markets because airport facilities were available for new entry at Newark. In fact, the combining carriers planned to use a new terminal being constructed for People Express at Newark and would surrender People Express' old terminal and ten gates used by the Texas Air carriers, so these facilities could be used by other airlines. Carriers wishing to enter the Washington-New York-Boston corridor markets or other Northeastern markets could also

obtain access at Boston's airport and at least one Washington, D.C. facility. At Denver, where there had been a substantial overlap between the services of Continental and Frontier before the latter's suspension of all operations, airport gates were available to new entrant carriers.

This brings us to the four cases decided by the Department, Mr. Chairman, that were the most difficult -- the Pacific Division Transfer Case, where we approved United Airlines' acquisition of Pan American World Airways' international Pacific operations, Order 85-11-67 (October 31, 1985); the NWA-Republic case, Order 86-7-81 (July 31, 1986); the TWA-Ozark case, Order 86-9-29 (September 12, 1986); and the Texas Air-Eastern cases, Order 86-8-77 (August 26, 1986) and Order 86-10-2 (October 1, 1986). While the Department of Justice disagreed in some manner with our result in these cases, in the Pacific Division Transfer Case the disagreement concerned only the procedures for determining whether United's Seattle-Tokyo route should be transferred to another carrier, and in the Texas Air-Eastern case the disagreement concerned the amount of potential replacement service required to maintain competition in the shuttle markets. Only in the NWA-Republic and TWA-Ozark cases did we approve acquisitions that Justice thought should be disapproved outright.

In the Pacific Division Case, we ultimately disagreed with Justice on the disposition of a West Coast Gateway -- Seattle/Portland. We began our inquiry with a consideration of the following:

United had authority to operate flights between Seattle and Tokyo, but the U.S.-Japan bilateral agreement limited United to seven round-trip flights per week, and United could not serve any point beyond Tokyo on those flights. Pan American, however, like Northwest, had unlimited rights to serve Tokyo from several U.S. gateways, and each had some authority to serve Asian points beyond Tokyo on their U.S.-Japan flights. Northwest, which had become the dominant U.S. carrier in the North Pacific markets, and Pan American were operating, respectively, 42 and 32 weekly round-trip flights between the United States and Japan; Japan Air Lines operated 46 weekly flights, and several carriers from other Asian countries provided additional service between the United States and Japan.

We concluded that United's acquisition of Pan American's Pacific operations would not reduce competition, since the restrictions on United's Seattle-Tokyo service had limited United's ability to compete and Pan American's longstanding financial problems impaired its ability to expand service. In addition to the service operated by Northwest and Japan Air Lines, several other Asian carriers provided competitive transpacific service, and the United States had recently won the right to award U.S.-Japan scheduled-service operating authority to two additional U.S. passenger carriers (we have since authorized American to provide Dallas-Fort Worth-Tokyo service and Delta to provide Portland-Tokyo service).

The Department of Justice urged us to disapprove the merger unless we conditioned our approval on a requirement that United be required to give up one of the West Coast gateways held by it or Pan Am. We did not accept this position because, as shown, we found that the acquisition would not be anticompetitive. We did agree, however, to consider, in a separate proceeding, the possible spin-off of United's Seattle/Portland-Japan authority to another carrier. That case was instituted and set for hearing before an administrative law judge by Order 86-9-92, September 30, 1986. Applications to replace United have been filed by American and Continental Airlines. Direct exhibits were filed on January 22 and rebuttals on February 19. The hearing began on March 9 and ended March 12. Thus, the Department will soon decide in this proceeding whether United or another carrier should be selected to serve this route.

Our second difficult case involved the acquisition of Republic by NWA, the parent corporation of Northwest Airlines. Both Northwest and Republic used Minneapolis-St. Paul ("MSP") as a hub. Northwest and Republic competed on 26 MSP city-pair routes and together provided the majority of flights operated at MSP. The record in our proceeding, however, contained little evidence that the acquisition was likely to cause a substantial reduction in competition in any MSP market. The increase in Northwest's market share at MSP would not be of concern unless competition from other carriers would not prevent Northwest from charging supra-competitive fares. The only party opposing the acquisition was

Justice, for Wisconsin supported the acquisition and no state or other civic party or carrier opposed it. We carefully examined the arguments made by Justice, but we could not find persuasive support in the record for those arguments, and as an opponent of the acquisition, Justice had the burden of proof. The record of evidence instead indicated that connecting and one-stop service offered by other carriers would discipline the applicants' nonstop services in MSP markets, and that other carriers could compete in the applicants' MSP markets without establishing a hub at MSP. The evidence thus suggested that other carriers could enter Northwest's MSP markets with "tag-end" service, i.e., flights originating at one point and operated through Minneapolis-St. Paul to another point, since the carriers commonly operated "tag-end" service in other hub markets. The record additionally showed that adequate facilities were available at the Minneapolis-St. Paul airport for carriers wishing to institute or expand service in the applicants' markets or to create a hub at MSP. Moreover, Justice had no factual or analytical support for its argument that a 79 flight hub was necessary to maintain competition, for nothing in the record suggested that another carrier could not practicably establish a smaller-scale hub. In addition, we could not agree with Justice's assumption that the competitive service lost through the merger had to be replaced by a single carrier operating a hub at MSP; instead, competition could be provided by several different carriers. We carefully analyzed each of the city-pair markets affected by the merger to determine whether other carriers would have the ability to enter if Northwest

attempted to charge excessively high fares, and we found that other carriers could provide competitive service in these markets.

Trans World Airlines' acquisition of Ozark Airlines also involved a combination of two carriers sharing the same hub, in this case, St. Louis. The Department of Justice contended that the acquisition should be disapproved on essentially the same grounds as those advanced in the NWA-Republic case. We found that the record did not support the Department of Justice's position. We concluded that the acquisition would not reduce competition at St. Louis, the common hub. Other carriers could offer competitive service in the applicants' markets without establishing a hub at St. Louis and because the St. Louis airport had facilities available for potential new entrants. In addition, Southwest Airlines had begun serving several St. Louis markets and already had access to the airport facilities necessary for establishing a substantial hub operation (60 flights per day) at St. Louis. We found that the record did not support the arguments of the Department of Justice (the transaction's only opponent) that competitive discipline would not be provided in the applicants' St. Louis markets unless another carrier built a hub at St. Louis and that barriers to entry would prevent a competitor's creation of a hub at St. Louis. Although Justice argued that competition could not be preserved unless another carrier created a hub at St. Louis with at least 89 flights each day, Justice failed to submit evidence showing that a hub of that size was competitively necessary.

The other difficult case involved Texas Air's proposed acquisition of Eastern, an acquisition that we initially disapproved and later approved only after Texas Air and Eastern cured the major competitive problem presented by the acquisition, the substantial reduction of competition in the Washington-New York and New York-Boston shuttle markets. Without the remedial action, Texas Air would have controlled the only two carriers then providing shuttle-type service, Eastern and New York Air.

We determined that the acquisition would substantially reduce competition in the shuttle markets unless Texas Air gave up enough slots at Washington National and LaGuardia necessary to enable another carrier to institute frequent service in the shuttle corridor. Effective competition in the shuttle markets requires the operation of frequent service, and providing such service required the possession of a large block of slots spread throughout the day. Despite our buy-sell rule for slots, no other carrier had enough usable slots, or could acquire the additional number needed, for the operation of frequent service. After we began the hearing process on Texas Air's initial acquisition proposal, Texas Air agreed to transfer a significant number of slots to Pan American for use in operating a competitive shuttle service. The Department of Justice had advised Texas Air earlier that it was likely to oppose the acquisition unless Texas Air tooks steps to ensure the maintenance of competition in the shuttle markets, but the Department of Justice concluded that Pan

American was purchasing enough slots from Texas Air to prevent the acquisition from substantially reducing competition in the shuttle markets and that Texas Air's acquisition of Eastern accordingly should be approved expeditiously. Despite Pan American's receipt of the additional slots, it would still have had too few slots, especially at peak hours, to provide hourly service in the shuttle markets -- markets dominated by business travellers -- throughout the day. We concluded that, as a result, the shuttle markets would suffer a significant loss of competition. The lack of an ability to offer hourly service, especially at peak times, would severely handicap Pan Am's competitive effectiveness. We therefore disapproved Texas Air's proposed acquisition of Eastern. Thus, while we shared the same basic competitive concerns of the Department of Justice - that the transaction would reduce competition in Washington/New York/Boston shuttle services - we found that the remedy proposed by the proponents of the transaction and accepted by Justice was not sufficient to address those concerns. We therefore disapproved the transaction.

After we disapproved the acquisition, Texas Air and Eastern agreed to sell Pan American enough additional slots at Washington National and LaGuardia airports so that Pan American could operate effective competition for the Eastern shuttle. As a result, we found that the acquisition, as so modified, would not reduce competition in the shuttle markets.

Although we have always believed that the Department of Justice should exercise the responsibility for reviewing airline acquisitions, we have faithfully carried out Congress' instructions that we approve only those acquisitions which are not likely to cause a substantial lessening of competition. While we have disagreed with the Department of Justice in a few cases, our disagreements stem from a difference of opinion on factual matters in the record of the particular proceeding, not from a difference of opinion on the importance of maintaining competition. And in only two cases -- NWA - Republic and TWA-Ozark -- have our two agencies fundamentally disagreed over the basic question of whether the transaction should be allowed to go forward.

The Department is on record in favor of sunsetting section 408, in favor of more efficient procedures, incorporated in section 7 of the Clayton Act, at the earliest possible time.

Mr. Chairman, I realize I have put you and the members of your subcommittee through an exhaustive catalogue of our activities and an extensive review for the basis of our actions. Given your interest and the interest of the public in the subject, however, I believe this hearing deserves the detail provided.

Let me add in closing that we at the Department take our responsibility to protect the aviation system -- and the American people -- from anti-competitive behavior very, very seriously. We exercise that responsibility with great care and concern. We also

are mindful of the fact that it is the energy, ingenuity and hard work of the American people that drives the engine of our economy and government should act wisely not to stall that engine through unwise regulation. Given the guidance we have received from the Congress through the Airline Deregulation Act, the Department has labored to protect the public interest and stay out of the way of legitimate economic progress. I believe we have succeeded.